

ST 99-20

Tax Type: Sales Tax

Issue: Audit Methodologies and/or Other Computational Issues

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**"JOAN WILDER", d/b/a "Romancing
The Stone Restaurant",**

Taxpayer

No. 97-ST-0000

IBT: SF-1900000000000000

Christine O'Donoghue
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Alan Osheff, Special Assistant Attorney General for the Illinois Department of Revenue. "Joan Wilder" appeared pro se.

Synopsis:

This matter comes on for hearing pursuant to "Joan Wilder's" ("taxpayer") timely protest of the Notice of Tax Liability assessing Retailers' Occupation Tax ("ROT") for the period of November 1, 1990 through October 31, 1992. The issue as identified by the parties in the pre-hearing order is "[w]hether the projection used by the auditor, which was based upon two register tapes, was reasonable." Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayer.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the NTL issued on May 15, 1996 reflecting a liability of \$21,465.00 for the period of November 1, 1990 through October 31, 1992. Dept. Ex. Nos. 1 and 2.
2. The auditor determined the taxpayer's taxable receipts by analyzing two cash register tapes received from a Special Agent of the Department's Bureau of Criminal Investigations. The auditor projected the amounts reflected on the cash register tapes to the remaining months of the audit period. Taxpayer Ex. No. 1; Tr. pp. 22, 24, 25.
3. Subsequent to the issuance of the NTL and while the matter was pending in Administrative Hearings, the case was sent back to the auditor to conduct a re-audit. During this re-audit "Joan Wilder" submitted bank deposit slips and purchase invoices. Tr. pp. 25, 34.
4. The auditor reviewed the bank deposit slips and invoices. Tr. pp. 25-27. No adjustments were made as a result of these new records. Dept. Ex. Nos. 1 & 2.
5. During the course of the re-audit, the taxpayer informed the auditor that she could obtain additional information in her effort to establish the correct amount of taxable receipts for the audit period. Tr. pp. 34, 35. Despite the taxpayer's offer of additional business records, the auditor advised the taxpayer not to pursue the matter. Tr. p. 35. During the re-audit, the auditor determined that he would not make any changes to the original audit methodology. Tr. p. 35.

Conclusions of Law:

The Retailers' Occupation Tax Act, 35 **ILCS** 120/1 *et seq.* imposes a tax upon persons engaged in the business of selling at retail, tangible personal property 35 **ILCS** 120/2. Further, it is presumed that all sales of tangible personal property are subject to tax under the Act and the burden is on the taxpayer to prove that a transaction is not subject to tax. Taxpayers are required to keep adequate books and records of all such sales. *See*, 35 **ILCS** 120/7; 86 Ill. Admin. Code ch. 1, Sec. 130.801 *et seq.*

In the instant case, a Notice of Tax Liability was issued for the period of November 1, 1990 through October 31, 1992 as a result of an unpaid field audit liability. At the hearing, the taxpayer disputed the audit results on two grounds. She acknowledged that while the business was open seven days a week upon its opening in late 1990, sometime thereafter, sales declined so drastically that the business was open only five or six days a week until finally during its last days, it was open only three days a week. Taxpayer argued that since the audit did not make allowances for this reduced schedule, the sales figures were inflated. Tr. pp. 7, 8. Secondly, the taxpayer maintained that the auditor's methodology was unreasonable given her offer of additional documentation which would have impacted the audit liability, specifically, records showing various business loans from both banks and friends during the pertinent time period. Tr. p. 27.

Pursuant to statute, the Correction of Return/Determination of Tax due is *prima facie* correct, thus once the Correction of Returns is admitted into evidence, the burden shifts to the taxpayer to overcome the presumption of validity. 35 **ILCS** 120/4. A taxpayer cannot overcome the presumption merely by denying the accuracy of the

Department's proposed assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988). Instead, the taxpayer must produce competent evidence, identified with its books and records which proves the Department's returns are incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968).

As previously noted a taxpayer is required pursuant to statute to keep books and records to accurately record retail sales of tangible personal property. If a taxpayer fails to supply the Department with records to substantiate its gross receipts, the Department may use its best judgment to estimate the taxpayer's gross receipts, and, in doing so, the Department must meet a minimum standard of reasonableness. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). The statute does not require the Department to substantiate the basis for the corrected return, it is the taxpayer who bears the burden of showing that the audit method used failed to meet the minimum standard of reasonableness. *See*, Vitale v. Department of Revenue, 118 Ill. App. 213 (3rd Dist. 1983).

The taxpayer was the subject of an investigation by the Department's Criminal Investigations Unit, which thereafter referred the taxpayer for audit. Central to the dispute in this matter is the auditor's use of information received from the criminal investigator that ultimately served as the basis for the audit. Taxpayer contends that the auditor incorrectly determined the tax liability by unreasonably projecting the figures on two cash register tapes that the auditor had received from the Department's criminal investigator. Several important details remain unclear in the record, particularly, the nature of the information reflected on the cash register tapes, whether the taxpayer

submitted these tapes to the investigator upon a demand for all books and records or whether the investigator merely made purchases at the place of business. Tr. pp. 22, 24.

What is clear is the auditor's testimony at hearing. He testified that during the re-audit the taxpayer presented the auditor with a number of bank deposit slips and purchase invoices and although she offered to provide additional books and records, he nonetheless declined her offer. Tr. p. 35. No explanation is given as to his reasons. When questioned, though, he admitted that if the additional documentation had been provided, the audit liability might well have been reduced. Tr. p. 35. In light of such an admission, the reasonableness of adhering to the original audit methodology which entailed projecting the amounts on two cash register tapes across a two year audit period must be questioned.

As a result, the burden shifted to the Department to put forth evidence proving the audit methodology reasonable. It failed to do so. The parties agreed in the pre-trial order "[t]hat the issue to be decided was whether the projection used by the auditor, which was based upon two register tapes, was reasonable," however, nothing in the record proves that the auditor's estimates were reasonable under the given circumstances. Nor has it been shown that a demand for books and records was made either during the audit or in Administrative Hearings and despite such demand, the taxpayer was unable or unwilling to provide the promised documentation.

Although merely denying the accuracy of the Department's assessments, offering alternative procedures or arguing its audit methodology is flawed does not overcome the Department's *prima facie* case, (A. R. Barnes & Co., 173 Ill. App. 3d at 833-834; Mel-Park Drugs, 218 Ill. App. 3d 203 (1st Dist. 1991)), the evidence of record shows that the

auditor used estimates in the face of documentation tied to the business' books and records. Whether the taxpayer could have obtained all the promised information remains an open question since the auditor told her not to pursue it. Furthermore, I cannot evaluate the reasonableness of the auditor's methods or whether the information would have impacted the tax liability in this case because the auditor's workpapers and narrative are not part of the record, thus, much of the auditor's methodology and his basis for such are unknown.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Tax Liability SF 1900000000000000 should be cancelled.

Date: June 16, 1999

Christine O'Donoghue
Administrative Law Judge